

Prosecuting Cartels without Direct Evidence of Agreement

What is circumstantial evidence?

How do competition agencies use circumstantial evidence?

Is evidence of parallel conduct by competitors sufficient to prove an agreement?

Does how countries classify cartels affect how they use circumstantial evidence?

Is circumstantial evidence useful in countries that are relatively new to anti-cartel enforcement?

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Introduction

Cartels are agreements among competitors fixing prices, allocating markets or rigging tenders (bids). They are the most harmful of all types of competition law violations and should be sanctioned severely. Cartel cases are unique. The most important part of a cartel case is simply proving that such an agreement existed. But getting direct evidence of a cartel agreement can be difficult. Cartel operators work in secret and often do not co-operate with investigators. In these circumstances, circumstantial evidence can play an important role in proving the agreement.

Direct evidence of an agreement is that which identifies a meeting or communication between the subjects and describes the substance of their agreement. The most common forms of direct evidence are 1) documents (in printed or electronic form) that identify an agreement and the parties to it, and 2) oral or written statements by co-operative cartel participants describing the operation of the cartel.

Circumstantial evidence is evidence that does not specifically describe the terms of an agreement, or the parties to it. It includes evidence of communications among suspected cartel operators and economic evidence concerning the market and the conduct of those participating in it that suggests concerted action.

Circumstantial evidence is accepted in cartel cases in every country. It may be employed exclusively to prove an agreement, but it can also be used to great effect together with direct evidence. Circumstantial evidence can be difficult to interpret, however. Economic evidence especially can be ambiguous, consistent with either concerted or independent action. The better practice is to consider circumstantial evidence in a case as a whole, giving it cumulative effect, rather than on an item-by-item basis, and to subject economic evidence to careful economic analysis.

The careful, intelligent use of circumstantial evidence can significantly advance a country's anti-cartel effort. ■

What is circumstantial evidence?

There are different types of circumstantial evidence. One type is evidence that cartel operators met or otherwise communicated, but does not describe the substance of their communications. It can be called “communication” evidence. It includes:

- records of telephone conversations (but not their substance) between competitors, or of travel to a common destination or of participation in a meeting, for example during a trade conference;
- other evidence that the parties communicated about the subject – *e.g.*, minutes or notes of a meeting showing that prices, demand or capacity utilisation were discussed; internal documents evidencing knowledge or understanding of a competitor’s pricing strategy, such as an awareness of a future price increase by a rival.

A second category of circumstantial evidence is often called “economic” evidence. There are two types of economic evidence. One is evidence of conduct by firms in a market and of the industry as a whole. It includes parallel pricing, abnormally high profits, stable market shares and a history of competition law violations. Economic conduct evidence also includes “facilitating practices” – practices that can make it easier for competitors to reach or sustain an agreement. Facilitating practices

Box 1.

BABY MILK CARTEL FROM ITALY

In October, 2005 the Italian Competition Authority announced that it had fined seven sellers of baby milk, comprising three legal entities, a total of €9,743,000 for engaging in a cartel in violation of Article 81 of the EC Treaty. The Italian Government had noted during the period 2000-2004 that these firms had engaged in parallel pricing of their products, and that their prices in Italy were significantly higher – between 150% and 300% – than prices in other European countries. The Authority developed evidence of contacts between the firms, both direct and indirect, that supported a finding of concerted action. Direct contacts included participation in special meetings at the headquarters of the manufacturers’ Association, following a request by the Health Minister to reduce prices. The evidence showed that there was open discussion among the manufacturers regarding their response to the Minister’s request, and that they agreed not to reduce prices by more than 10%.

Indirect contacts occurred as the respondents established recommended resale prices for pharmacies, which were the principal retail outlet for their product. Special characteristics of the market made it possible for sellers to compute their rivals’ wholesale prices by reference to their recommended resale prices.

The Authority noted that since it began its case in 2004, prices of baby milk had declined by 25% and there had been other pro-competitive developments in the market, including more advertising and consumer information, the introduction of new products and a greater presence of the respondents’ products in supermarket chains.

include information exchanges, price signalling, freight equalisation, price protection and most favoured nation policies, and unnecessarily restrictive product standards. It is important to note that conduct described as facilitating practices is not necessarily unlawful. But where a competition authority has found other circumstantial evidence pointing to the existence of a cartel agreement, the existence of facilitating practices can be an important complement.

A second type of economic evidence can be called “structural” evidence. It includes high concentration, low concentration on the opposite side of the market, high barriers to entry, a high degree of vertical integration and a standardised or homogeneous product. ■

How do competition agencies use circumstantial evidence?

Competition law enforcement officials prefer direct evidence, but as noted above it is not always available. It should be noted, however, that there is not necessarily a bright line between direct and circumstantial evidence, especially when considering various forms of communication evidence. Further, all types of evidence – direct and circumstantial – are helpful to the competition law enforcer. They can be, and often are, used together. And finally, quality matters. Direct evidence in the form

Box 1. (cont.)

BABY MILK CARTEL FROM ITALY

Here is a list of the types of evidence employed by the Competition Authority in the case:

- direct evidence: the producers apparently agreed on a maximum price reduction;
- communication evidence: the producers had met at the trade association and discussed prices, although with the exception of the maximum price reduction there was no direct evidence that they had reached an agreement;
- conduct evidence: parallel pricing; steep price reductions and increased competition following the investigations which suggested that earlier high prices were not the result of competitive behaviour;
- conduct of the entire industry: the prices were significantly higher than in other European countries;
- market structure evidence: this was a highly concentrated industry with only three independent suppliers, and they sold a relatively homogenous product; and
- facilitating practices: recommended resale prices for pharmacies with significant price transparency; sales occurred predominantly through pharmacies, eliminating outlets such as grocery stores that likely would have used discount prices.

of testimony from a single, unconvincing witness is less credible than strong and cumulative circumstantial evidence.

Cartel cases in which there is no direct evidence of agreement often begin in a familiar way: there is an episode of suspicious parallel pricing or other behaviour that is not readily explained by usual market forces. By definition the competition agency cannot directly prove that the conduct is the result of an agreement. The question presented is, what amount and quality of circumstantial evidence is sufficient for this purpose?

There is almost universal agreement that of the two types of circumstantial evidence described above, communication and economic evidence, communication evidence is the most probative of an

Box 2.
BLOMKEST FERTILIZER

The case involved allegations by fertilizer manufacturers that eight potash producers had conspired to fix the price of potash between 1987 and 1994 (potash is an important input into fertilizer). The plaintiffs' case consisted mostly of economic evidence, which included evidence of a pattern of price verifications by the defendants, a form of economic conduct evidence.

The case was heard by all of the eleven judges on the appeals court, a rarity in US practice. The eleven judges split six to five in favour of the defendants, affirming the decision of the trial court to dismiss the case. The majority found the price verification evidence unpersuasive, first because it occurred only as to past transactions, and as such would have minimal implications for future pricing, and second, because in the court's words:

"The price verifications relied upon were sporadic and testimony suggests that price verifications were not always given. The fact that there were several dozen communications is not so significant considering the communications occurred over at least a seven-year period in which there would have been tens of thousands of transactions. Furthermore, one would expect companies to verify prices considering that this is an oligopolistic industry and accounts are often very large. We find the evidence falls far short of excluding the possibility of independent action."

The minority argued persuasively that such conduct would not have been in the defendants' interest if they had not been participating in a cartel:

". . . if there were no reciprocal agreement to share prices (and the producers certainly do not argue that there was), an individual seller who revealed to his competitors the amount of his privately negotiated discounts would have been shooting himself in the foot. On the other hand, if there were a cartel, it would be crucial for the cartel members to cooperate in telling each other about actual prices charged in order to prevent the sort of widespread discounting that would eventually sink the cartel."

As noted above, however, this view did not prevail in the case.

agreement. A review of cartel cases prosecuted in OECD countries in which circumstantial evidence was important showed that in almost all successful cases there was communication evidence. Economic evidence, on the other hand, is ambiguous. It could be consistent with either agreement or independent action. Therefore it requires careful analysis. Finally, the better practice is to use circumstantial evidence holistically, giving it cumulative effect, rather than on an item-by-item basis. The “Baby Milk Cartel” case (see Box 1) is an example of one in which several different types of evidence were used. ■

Is evidence of parallel conduct by competitors sufficient to prove an agreement?

No. In almost every country it is not sufficient simply to show that competitors acted in parallel fashion, because such conduct could be consistent either with agreement or with independent action taken by each competitor unilaterally. One formulation, sometimes employed by courts in the United States is “conscious parallelism plus”. There must exist, in addition to parallel conduct, certain “plus factors” that make it more likely than not that there was concerted action. Relevant plus factors include both communication and economic evidence of the types discussed above.

The fundamental task in the analysis of parallel conduct is to exclude, with reasonable certainty, the possibility that the parties were acting unilaterally, according to what each perceived was in its own best interest. For example, when a competitor raises price in response to a rival’s price increase, such activity may be fully consistent with each firm’s unilateral best response. If one cannot condemn a firm for lowering its price in response to rivals’ lowering their prices, then one could not do so for price increases. Something more needs to be shown. A formulation for making this decision is sometimes called “action against self-interest”. That is, it must be shown that it was against the self interest of the parties to take certain actions unless they were acting collectively, i.e., there was an agreement.

Courts have struggled with this standard, however. The “Blomkest Fertilizer case” from the United States illustrates the difficulty of making this judgment.

Economic theories of oligopoly provide valuable insights on interpreting economic evidence. Generally speaking, one can distinguish three broad categories of economic models that describe firm behaviour. First, firms can independently pursue their “unilateral non-cooperative best response” given what rivals are doing. In these types of models the market equilibrium is determined when each firm pursues its best response given its rivals’ best response. This type of equilibrium, “best responses to best responses”, is typically called a Nash equilibrium.

A second class of models argues that firms may at times recognize that mutual accommodation is in their best interests. Theories of this type indicate that certain actions by a firm are only profitable given an accommodating response by their rivals. Importantly, it should be understood that in models that feature accommodation, firms do not reach an explicit (unlawful) agreement through communication with each other, but rather come to understand what was in their mutual best interests through market place interactions.

A third class of firm behaviour involves cartels. Here the key feature is that firms explicitly reach an agreement through some form of communication with one another. Evidence of that communication may be lacking, however, and so the task of the competition agency is to identify economic evidence that is of high quality and hence useful at discriminating among competing theories. The competition authority should have a good sense of the appropriate model that best describes the incentives of a firm to compete in the market that is being investigated. First, the authority must identify the set of actions that can be characterised as unilateral, non-cooperative best response behaviours in a given case. Then, and only then, can it identify actions that are inconsistent with that behaviour and thus support the hypothesis that an illegal cartel was formed. In other words, actions compatible with unilateral, non-cooperative best response behaviour serve as a benchmark to which a firm's behaviour can be compared during the period of suspicious activity. Economics provides tools for making this assessment, but it must be said that in most cases to date this kind of formal economic analysis has not been done. ■

Does how countries classify cartels affect how they use circumstantial evidence?

In most countries, cartels (and other violations of the competition law) are prosecuted administratively. The principle administrative sanctions applied to this conduct are fines, usually only assessed against organisations but sometimes against natural persons, and remedial orders. In a minority of countries, but a growing one, cartels are prosecuted criminally. In most instances the burden of proof facing the competition agency is higher in a criminal case. The result is that it is usually more important that direct evidence of agreement be generated in these cases. The United States has long used the criminal process in the cartel cases prosecuted by the government, and virtually all of its cases are built on direct evidence. Still, circumstantial evidence is admissible, and useful, in that country and elsewhere. ■

Is circumstantial evidence useful in countries that are relatively new to anti-cartel enforcement?

A country just beginning to enforce its competition law may face obstacles in obtaining direct evidence of a cartel agreement. It probably will not have in place an effective leniency programme, which is a primary source of direct evidence. (A leniency programme offers relief from sanctions to the first cartel participant to offer co-operation with the investigator.) There may be lacking in the country a strong competition culture, which could make it more difficult for the competition agency to generate co-operation with its anti-cartel programme. In short, the competition agency could have relatively greater difficulty in generating direct evidence in its cartel cases, which would imply that it will have to rely more heavily on circumstantial evidence. But there is a countervailing phenomenon: the relatively high incidence in these countries of “naïve cartels” – cartels whose members do not attempt to conceal their activity, either because they are unaware that their conduct is unlawful or because they are not sufficiently sophisticated to do so. In the case of naïve cartels direct evidence is relatively plentiful, rendering circumstantial evidence less important. Thus, the situation in these countries may vary on a case-by-case basis, but it is clear that circumstantial evidence may be quite useful in the right circumstances. ■

For further information

For more information on the OECD’s work on competition policy, please see our website at www.oecd.org/competition or contact dafcomp.contact@oecd.org.

For more information about this Policy Brief and the report on “Prosecuting Cartels without Direct Evidence of an Agreement”, please contact Edward Whitehorn, tel.: +33 1 45 24 83 81, e-mail: edward.whitehorn@oecd.org.



For further reading

OECD (2007), **Journal of Competition Law and Policy**, ISSN 1560-7771, Subscription (3 issues per year), € 152.

The following are available for download at: www.oecd.org/competition.

OECD (2005), **Best Practices for the Formal Exchange of Information between Competition Authorities in Hard Core Cartel Investigations**.

OECD (2005), **Hard Core Cartels: Third Report on the Implementation of the 1998 Recommendation**.

OECD (2003), **Hard Core Cartels: Recent Progress and Challenges Ahead**, ISBN 978-92-64-10124-1, 64p., € 25.

OECD (2002), **Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programmes**, ISBN 978-92-64-19735-0, 85p., € 36.

Recommendation of the Council Concerning Effective Action against Hard Core Cartels (1998).

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